BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HARRY AND PEGGY GROMAN)

Appearances:

For Appellants: Harry Groman, in pro. per.

For Respondent: Mark McEvilly Counsel

O P I N I O N

This appeal was originally made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Harry and Peggy Groman against a proposed assessment of additional personal income tax in the amount of $11,970.76 for the year 1976. Subsequent to the filing of this appeal, appellants paid the proposed assessment in full. Accordingly, pursuant to section-19061.1 of the Revenue and Taxation Code, this appeal is treated as an appeal from the denial of a claim for refund.

Appeal of Harry: and Peggy Groman

On their joint California personal income tax return for 1976, appellants claimed a $66,640 deduction for nonbusiness bad debts attributable to one Stanley Rose (hereinafter referred to as "Rose"). In connection with an audit examination of appellants' records, respondent acquired documentation indicating that appellant-husband had made advances to Rose from April 13, 1970 through November 30, 1973, in the total amount of $66,640.08. During this period, Rose was appellant-husband's son-in-law and served as vice-president of Groman Mortuaries, Inc., a company controlled by appellant-husband. The latter dismissed Rose from his position in late 1973 or early 1974.. On June 12, 1975, Rose's spouse filed for dissolution of marriage; the divorce became final on January 26, 1977.

From April 1974 through April 1975, three banks filed suit against the Roses for failure to repay loans totaling $67,000; each of these loans was made to Rose and guaranteed by his wife: Judgments were entered against the Roses in all three lawsuits. While the record of this appeal does not specifically reveal that these judgments, remained unpaid; appellants have asserted that Rose was "judgment proof."

Appellants argue that the subject advances became uncollectible in 1976, the year Rose's employment with an unidentified firm was terminated, and should be allowed as a bad debt deduction. To support their contention, appellants have provided the following: (i) a copy of a ledger maintained by appellant-husband showing the dates and amounts of the advances in issue; (ii) copies of checks, some of which bear the inscription "loan," made payable to Rose totaling $41,007.20; and (iii) a list of lawsuits filed against Rose for nonpayment of loans. The list provided by appellants is apparently designed to support their assertion that he was insolvent.

Respondent's primary contention is that appellants are hot entitled to the claimed bad debt deduction because they have not established that bona fide debts existed. In arriving at this conclusion, respondent has relied, in part, upon the following factors: (i) Rose did not sign a promissory note or other evidence of indebtedness; (ii) security for the purported loans wasneither requested nor provided; and (iii) there existed no fixed repayment schedule, maturity dates, or provision for interest. In the alternative, respondent contends that if the subject

advances were in fact bona fide loans, appellants have failed to establish that they became worthless in 1976.

Appellants rely upon section 17207 of the Revenue and Taxation Code to support their position that the amounts advanced to Rose are deductible as bad debts. That section provides for the deduction of "any debt which becomes worthless within the taxable year." Section 17207 is substantively identical to section 166 of the Internal Revenue Code of 1954. Accordingly, federal case law is highly persuasive in interpreting the California statute. (Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).) Appellants bear the burden of establishing that they are entitled to the claimed bad debt deduction. (W. B. Hayes, , '21 T.C. 286 (1953); Appeal of Justin M. Wool, Cal. St. Bd. of Equal., April 10, 1972.)

The initial question presented for our determination is whether the subject advances to Rose constituted bona fide loans. The secondary issue of whether these advances became worthless in 1976 arises only if the answer to the first inquiry is affirmative.

A bona fide debt "arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." (Former Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3), repealed May 16, 1981.) No deductionmay be taken for a loan made with no intention of enforcing payment (C. B. Hayes, 17 B.T.A. 86 (1929)), or where there was no reasonable expectation of repayment when the loan was made. (Appeal of Harry P. and Florence O. Warner, Cal. St. Bd. of Equal., April 22, 1975.) Intra-family transactions are subject to rigid scrutiny and are particularly susceptible to a finding that the transfer was intended as a gift rather than a debt. (Mabel C. Harris, ¶ 73,150 P-H Nemo. T.C. (1973); William Francis Mercil, 24 T.C. 1150 (1955); Appeal of Harry P. and Florence 0. Warner, supra; Appeal of Arthur and Kate C. Heimann, Cal. St. Bd. of Equal., Feb. 26, 1963.)

Upon careful review of the record on appeal, we are convinced that the subject advances were not made with any reasonable expectation of repayment. That record reveals that Rose apparently had no means of repaying the substantial amounts advanced. The latter's standard of living during the period in which the advances were made was apparently substantially in excess of his income as the record of this appeal

reveals that he borrowed large sums of money from others in addition to the advances from his father-in-law. Furthermore, the previously mentioned list of lawsuits brought against Rose reveals that at least one such action for nonpayment of a debt was filed during the same period in which the subject advances were being made.

Our conclusion that bona fide debts did not exist is buttressed by the factors cited by respondent. Specifically, Rose never provided appellants with promissory notes, security was neither requested nor provided, and repayment schedules, maturity dates, and provisions for interest were nonexistent. In numerous prior cases, these factors, when viewed in the aggregate., have been found sufficient to sustain a finding that advances of the type in issue did not constitute bona fide debts. (See, e.g., Mabel C. Harris, supra; Appeal of Harry P. and Florence O. Warner, supra.) In view of these factors, the mere fact that a portion of the advances to Rose were made by checks bearing the inscription "loan" is not determinative as to the nature of the transfers. Moreover, the notations in the ledger maintained by appellant-husband simply indicate that the advances were made, not that they constituted bona fide loans.

For the reasons set forth above, respondent's action in this matter will be sustained.

Appeal of Harry and Peggy Groman

O-R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Harry and Peggy Groman for refund of personal income tax in the amount of $11,970.76 for the year 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of December, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Ernest J. Dronenburg, Jr., Member

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_____, Member